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China State Administration of Taxation clarifies the tax issues related to court auction of foreign vessel in the case of M/T “AMIN2”

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In the recent years, it is not rare to see dispute on vessel's credit under fluctuated shipping market. In the cases involving ship finance loan, ship building and ship mortgage dispute etc., the disputed figure are very substantial and the ships in many cases are unavoidable to be auctioned by maritime court. Before the case of M/T “AMIN2”, it is a blank zone in taxation area that whether and how the taxation authority shall impose levy upon the proceeds in court auction. It leads to the problem that the auction proceeds could not be cleared from taxation control and distributed to the foreign creditors as there is no guidance on how to proceed the taxation declaration formalities.

In the case of dispute on mortgage of M/T “AMIN2” in which Wang Jing & Co., Xiamen represented a German bank, China State Administration of Taxation (“SAT”) replied and clarified for the first time that whether and how should the bank entitled loan, interest and other fees related to bank (arrest applicant) and the fund collected by shipowner through court auction be imposed levy. We believe this reply will provide guideline for other cases related to how to handle the taxation application procedure on collection of ship auction proceeds

Case background: In November 2013, a German bank with our representation applied to Xiamen Maritime Court for vessel arrest of M/T “AMIN2” based on vessel mortgage. In October 2014, the Xiamen Maritime Court successfully auctioned the vessel with RMB 324 Million. The bidder was a company registered in Hong Kong. In March 2016, the German bank and the ship owner registered in Iran reached a settlement agreement, in which the German bank will be compensated with about RMB208 Million in total. Due to the huge amount of the funds, this auction has attracted extensive attention from foreign and domestic shipping industry. At the same time, it also brought the supervision by taxation department upon the taxation issues in respect of the bank loan interest and the payable taxation by the ship owner.

Through the case review and investigation for almost one year, China STA headquarter replied that as for the German bank’s loan interest, as the German bank as German tax resident and the owner of interest income and the interest income was from the company in Iran rather than interest income from China. According to the Agreement between the Government of the People’s Republic of China and the Government of the Bundesrepublik Deutschland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, the taxation could be exempted in China.

As to whether the remaining auction proceeds entitled by shipowner should be subject to value-added tax (“VAT”), VAT additional tax, business income tax and stamp tax, the STA clarified that:

1. According to the current VAT regulation, for goods sold in China mainland, the seller is the taxpayer of VAT where the carriage shipment of goods or the place of goods is in China mainland. So the transaction of M/T “AMIN2” in China fall within the scope of VAT. However, according to the current export policy, China imposes zero taxation on export goods by way of exemption from taxation, taxation return or taxation offsetting. The export of vessel belongs to good expert, M/T “AMIN2” was exported to Hong Kong as the bidder is a Hong Kong company, thus the export of this vessel should be exempted from VAT.
2. Since no VAT shall be imposed, naturally the VAT additional tax should also be exempted.
3. As for the interest accrued from the proceeds deposited in Chinese bank account,

according to Paragraph 3 in Article 3 of the Enterprise Income Tax Law, Article 91 of the Regulations Enterprise Income Tax Law People's Republic China and Article 11 of the Agreement between the Government of the People's Republic of China and the Government of the Islamic Republic of Iran for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("China-Iran Taxation Agreement"), the Iran company should pay income tax for the interests in amount not exceed 10% of the total interest income.

4. For the income arising from property transfer and international transportation, Iran company operates its chartering business in China through M/T "AMIN2" which shall be deemed as providing international transportation service in China. M/T "AMIN2" satisfies the requirement as institution and place in Paragraph 2 in Article 3 of Enterprise Income Tax Law and Article 5 of the Regulations Enterprise Income Tax Law People's Republic China and she also constitutes the main operating assets for the Iran company's institution and place. Therefore, the Iran Company's income from property transfer and international transportation should declared for business income tax levy in China. However, as the Iran company is Iranian taxation resident. According to China-Iran Taxation Agreement, income from transfer of property and income from international transportation could only be imposed with taxation in Iran.

5. No stamp tax shall be levied as there is no written agreement for transferring the title of M/T "AMIN2" between seller and buyer.

From the SAT replies, we could interpret the taxation rules as follows:

1. Auction of the vessel by Chinese court is deemed as selling goods in Chinese mainland, in which the shipowner is the obliged taxpayer of the VAT. If the Buyer is a company registered in China, according to the Notice on Taxation upon Imports of Ship issued by the Ministry of Finance and SAT, the Buyer should pay import custom tax and VAT. The exemption of VAT policy would be applied only when the Buyer is a foreign company. For the issue whether the shipowner as Seller should pay tax (VAT and income tax etc.) or not, according to the SAT reply, the Seller should pay tax but the taxation should be subject to bilateral taxation agreement.

2. If any VAT shall be paid, the VAT additional tax should also be paid.

3. Interest accrued since the date of deposit into the court bank account should be subject to income tax. The applicable tax rate is usually 10%. In this respect, the SAT also implies that the interest income of the auction proceeds should belong to shipowner (thus income tax should be imposed upon shipowner).

4. The income arising from property transfer in court auction and the income generates from international transportation such as hire income which connection to China should be subject to income tax (usually 25%). However, if the bilateral taxation agreement provides otherwise like shipowner could only pay tax in taxation resident country, then the bilateral agreement shall be applied.

5. In the case that the ownership is transferred to special administrative zone like Hong Kong or foreign country, no stamp tax would be involved as the parties did not sign relevant title transfer documents before Chinese authorities.

In conclusion, the general tone of SAT is that if the vessel operation and fund generation are related to China, it should be subject to Chinese taxation. As for whether it could be exempted by Chinese policy or bilateral taxation agreement, it should be determined on case-by-case basis.

Meanwhile, given the SAT's strict supervision rules and close cooperation between the court system and SAT system, we recommend make comprehensive consideration in choosing the buyer company and the bilateral taxation agreement when participating in bidding in the court auction, so as to avoid taxation problems and the additional unnecessary taxation burden.

[KIND REMINDER]

The above are merely some simple understanding given on the basis of our reflection during the process of handling maritime disputes. As the first Chinese regulations concerning the independent guarantee, it is believed that the new Judicial Interpretations on Independent Guarantees will provide useful guidance for the trial practice of disputes over maritime security. Hope any issues that remain unclear and disputable could be clarified in the future judicial practice.